Memo to the Minister or Minister's Staff

Department of Finance
Canada

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MEMORANDUM NOTE DE SERVICE

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Our file Notre référence	
Your file Votre référence	2018FIN467908
Date	JAN 2 9 2018

TO
À Minister of Finance

FROM
DE Paul Rochon

SUBJECT
OBJET **Meeting on Creative Housing**

For information. To be read before your upcoming meeting with Minister Duclos and Ms. Jennifer Keesmaat to discuss a proposal from the Creative Housing Society regarding a potential partnership with Canada Mortgage and Housing Corporation to construct affordable rental housing.

Issue

You will be hosting a meeting with the Minister of Families, Children and Social Development and Ms. Jennifer Keesmaat, from the University of Toronto, to discuss a proposal from the Creative Housing Society developer to partner with the Canada Mortgage and Housing Corporation (CMHC) to deliver affordable rental housing (see Annex A).

You will be joined by Mr. Olivier Duchesneau, the Chief of Staff, and Mr. Dylan Marando, Senior Policy Advisor, to the Minister of Families, Children and Social Development. Mr. Evan Siddall, the President and Chief Executive Officer for Canada Mortgage and Housing Corporation, and Gerald Butts, Senior Political Advisor to the Prime Minister will also attend the meeting. A biography for Ms. Keesmaat is included in Annex B.

Background

As part of Government of Canada investments in infrastructure, a first-ever National Housing Strategy (NHS) was launched on November 22, 2017—a 10-year, $40 billion plan to help ensure that Canadians have access to housing that meets their needs and that they can afford (see Annex C). Through the NHS, the Government is aiming to reduce chronic homelessness by 50 per cent over the next decade and lift as many as 530,000 households out of housing need. The NHS will result in up to 100,000 new housing units and 300,000 repaired or renewed housing units. The Minister of Families, Children and Social Development is the lead Minister for the NHS.

The number of new rental housing units built each year has comprised just under 10 per cent of all residential construction in recent years. There are economic barriers to the construction of rental housing (e.g., municipal regulations and approval processes can reduce the return on rental units; condominiums can be pre-sold and deposits can be used towards the cost of

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Canada

development which is not the case for rentals). The shift from rental-unit construction to condominiums is most apparent in Vancouver, Toronto and Calgary.

Recent Government investments to address demand and supply imbalances by creating more affordable rental housing include the creation of a $15.9 billion federally managed National Housing Co-Investment Fund as part of the NHS, to ensure that existing rental housing is not lost to disrepair and to develop new, high-performing affordable housing integrated with supports and services. The Fund will consist of nearly $4.9 billion in financial contributions and $11 billion in low-interest loans and is expected to create up to 60,000 new units of rental housing and repair up to 240,000 units of existing affordable and community housing. The Fund would increase supply across the housing spectrum (from community housing and shelters to affordable home ownership) and is expected to help alleviate market pressures in cities like Toronto and Vancouver, where housing affordability is a key concern and a potential constraint in attracting and retaining talent. Partnerships are a central feature of the Fund to maximize investments, ensure coordination of efforts, and remove barriers to the development process.

The Creative Housing Society[1], incorporated on October 17, 2017, and headquartered in Toronto, seeks to develop affordable rental housing for those making at or below local median household incomes in the nation's major cities. The corporation is seeking to position itself as a new non-profit partner that can deliver at scale[2], with the experience and resources to entitle, construct, manage, and maintain large mixed-use projects in Toronto, Vancouver, Montreal, and Ottawa. Creative Housing would look at government sites, identify potential, and improve affordability by creatively adding density for market components. Creative Housing would endeavour to undertake all projects on surplus municipal, provincial, and federal government lands, along with Indigenous lands (on a partnership basis), enabling zero or net-zero acquisitions. The corporation would also focus on reducing carbon emissions by constructing energy-efficient buildings in downtown and transit-oriented locations. Creative Housing proposes that CMHC take on 80 per cent of the costs of the project at a 10-year Canadian rate plus 0.30 per cent with a 35-year amortization period. The proposal does not outline the total cost of the project, total Government support required or provide a timeline for implementation.

Considerations

[redacted]

[1] A partnership founded by Westbank and Allied Properties REIT.

[2] By scale, they refer to the number of housing units they anticipate being able to construct (5,000 within two to three years).

s.21(1)(a)

s.21(1)(b)

[redacted]

Given the commitment to allocate at least 25 per cent of NHS investments to support projects that specifically target the unique needs of women and girls, [redacted]

s.21(1)(a)

s.21(1)(b)

KEY MESSAGES

- Very weak supply of affordable rental units over the past few decades suggests economic barriers are constraining supply.
- Significant new investments under the National Housing Strategy require many partners to achieve ambitious targets.
- Partnerships involving financing from government and delivery via private-sector partners provide a good avenue to increase supply and alleviate market pressures.
- Ontario and Vancouver have announced a series of measures to increase the supply of rental housing over the next few years. How will Creative Housing take these into account?
- Through what means would Creative Housing help the Government meet its commitment to allocate 25 per cent of NHS investments to the needs of women and girls?
- Could you provide additional detail around the capital structure of the proposal in order to properly assess its feasibility?
- The feasibility of the proposed approach must be assessed in close cooperation with CMHC.

s.21(1)(b)

Jennifer Keesmaat
University of Toronto

Ms. Jennifer Keesmaat, M.E.S., MCIP, RPP is a Founding Partner of Office for Urbanism. Ms. Keesmaat served as a Chief Planner and Executive Director of City Planning at Toronto (City of). Ms. Keesmaat is a registered professional planner, an award-winning member of the Canadian Institute of Planners and a member of the Congress for New Urbanism. She was a Principal of Dialog Inc. She is a regular guest lecturer at York University, the University of Toronto and RyersonUniversity, where she speaks on diverse subjects that include policy development, urban development processes and implementation strategies.

Ms. Keesmaat is a distinguished visitor in planning at the University of Toronto. She has worked on urban design projects in cities across Canada, including in Halifax, Winnipeg, and Lethbridge.

Ms. Keesmaat has a combined honours B.A. degree from The University of Western Ontario and an M.E.S. degree in urban planning from York University in Toronto, where she studied the political processes that shape urban environments.

Annex C

Highlights of the National Housing Strategy

A vision for housing in Canada

Canadians have housing that meets their needs and they can afford. Affordable housing is a cornerstone of sustainable, inclusive communities and a Canadian economy where we can prosper and thrive.

Housing is more than just a roof over our heads

The National Housing Strategy Principles:

People

- Ensuring more Canadians have access to housing that is safe and that they can afford
- Prioritizing vulnerable persons
- Encouraging public participation in the development and evaluation of the policy

Communities

- Promoting diverse, inclusive communities by building sustainable, accessible and mixed use housing
- Empowering communities to develop and implement local solutions to housing challenges
- Promoting housing investments and life that supports Canada's climate change agenda to accessible communities

Partnerships

- Maintaining and prioritizing a resilient community housing sector
- Encouraging transparent and accountable partnerships to create better outcomes
- Recognizing that First Nations, Inuit and Metis Nation housing strategies must be co-developed and founded in the values of recognition of rights, respect and co-operation

A $40-billion once-in-a-generation investment

$15.9 billion
for the National Housing Co-Investment Fund

$4 billion
for Canada Housing Benefit*

$2.2 billion
for Homelessness Partnering Strategy

$9.1 billion
for Community Housing Initiatives*

$2.5 billion
for Federal-Provincial/Territorial Housing Partnership, including the North*

$9.8 billion
for existing agreements

* Includes cost-matching by provinces and territories

Stronger communities. Greater opportunities.

The NHS is a detailed 10-year plan that will deliver results and benefit all Canadians — including building more affordable, accessible, inclusive and sustainable homes.

100,000
new housing units created representing **4x** as many units built under federal programs from 2005 to 2015**

385,000
community housing units protected and another **50,000** created through an expansion of community housing

530,000
households removed from housing need

300,000
existing housing units repaired and renewed representing **3x** as many units repaired and renewed under federal programs from 2005 to 2015**

50%
reduction in estimated number of chronically homeless shelter users

300,000
households provided with an average of **$2,500/year** in affordability support through the Canada Housing Benefit

** Compared to units built and repaired through the Affordable Housing Initiative (AHI), Renovation Programs and the Investment in Affordable Housing (IAH).

New Tools and Partnerships

Federal programs

- Housing Rights are Human Rights
- National Housing Co-Investment Fund to build or repair housing with at least:
  - ✓ *20% accessible or universally-designed units*
  - ✓ *25% better energy-efficiency*
  - ✓ *20-year commitment to affordability*

- New federal social housing agreements
- New data and research to close knowledge gaps
- New resources for community housing
- Demonstration projects to share ideas and opportunities
- National Housing Council to guide the future of the strategy
- Surplus federal lands at low or no cost for affordable housing

Partnerships with the provinces and territories

- Preserve, renew and expand community housing for low-income Canadians
- Design and deliver a housing benefit for people in housing need
- Support local needs and priorities

Helping Canadians

At least 25% of National Housing Strategy Investments will support projects that specifically target the unique needs of women and girls

- ✓ Ongoing consultations, including an annual Women's Housing Symposium
- ✓ New and repaired shelter spaces
- ✓ Financial support through the Canada Housing Benefit
- ✓ Improved affordable housing options and increased shelter space through the National Housing Co-Investment Fund
- ✓ Ongoing community housing subsidies
- ✓ Targeted research on women's housing needs
- ✓ Affordable housing for senior women
- ✓ Improved housing affordability and safety through a human rights-based approach to housing

At least
7,000
SHELTER SPACES created or repaired for survivors of family violence
4,000 (NHS) + 3,000 (Budget 2016)

At least
12,000
NEW AFFORDABLE UNITS created for seniors
7,000 (NHS) + 5,000 (Budget 2016)

At least
2,400
NEW AFFORDABLE UNITS created for people with developmental disabilities

Department of Finance
Canada

Memo to the Parliamentary Secretary
or Secretary's Staff

PS Office. .... Orig. + 5
DMO.................................4
Assoc. DM and G7 Deputy 1
EFP............................ e-copy
C&C........................... e-copy
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MEMORANDUM NOTE DE SERVICE

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Originator Auteur	Lucie Pilon
Our file Notre référence	
Your file Votre référence	2018FIN468137
Date	

TO
À
Parliamentary Secretary

FROM
DE
Paul Rochon

SUBJECT
OBJET
Meeting with David Lefebvre, Vice President, Federal and Quebec, Restaurants Canada

For information. To be read prior to your bilateral meeting with David Lefebvre, Restaurants Canada.

You will be meeting with David Lefebvre, Vice President, Federal and Quebec, Restaurants Canada on February 1, 2018. We expect the meeting with Mr. Lefebvre will focus on issues raised in Restaurants Canada's pre-budget submission (see Annex A), specifically:

1. Labour Costs;
2. Credit card fees;
3. Alcohol Excise Duty Rates – Automatic Annual Inflationary Adjustment.

We also anticipate Mr. Lefebvre may also discuss the state of the restaurant sector in the Greater Quebec City area, federal tourism initiatives, and initiatives that the association is putting forward at the provincial level.

ADM: Michelle Kovacevic (613) 369-9572
Director General: Galen Countryman (613) 369-5662

Canada

BACKGROUND

Restaurants Canada is a national industry association representing 30,000 businesses in every segment of foodservice, including full and quick-service restaurants, bars, caterers, and institutional foodservice providers.

In its pre-budget submission, Restaurant Canada notes that the restaurant industry is one of the largest sectors of the Canadian economy with $80 billion in annual sales, 95,000 locations, and 1.2 million employees who serve 18 million customers every day. The submission indicates that an additional 286,000 people are indirectly employed as suppliers to their industry.

2018-19 BUDGET SUBMISSION DISCUSSION

1. Labour Costs

As part of its 2018-19 federal pre-Budget submission, Restaurants Canada has raised concerns regarding the impact of the recent minimum wages introduced by Alberta and Ontario, as well as the operating costs that the food industry is facing. Restaurants Canada is calling for federal support to address some of these cost drivers, which impact the productivity of the foodservice operators.

Restaurants Canada has stressed that the minimum wages introduced in Alberta and Ontario, and which may be adopted by other jurisdictions, would impact youth employment in their sector, as many employers cannot afford paying first-time employees the same wages as more experienced workers.

While Restaurants Canada has stated that it is already seeking mitigation from the provincial governments to address the job-loss impact, it also calls for the federal government to:

- Provide support in the form of fiscal incentives and tax credits to encourage the hiring and retention of young workers;
- Make job training grants more widely available to the restaurant industry;
- Promote hiring of youth employees by granting a 12-month holiday on Employment Insurance (EI) premiums; and
- Make EI claimants eligible for labour mobility or transportation allowances.

If this issue is raised, you may wish to note:

- ***The Government of Canada recognizes the significant contribution that the restaurant and foodservice industries make to the national economy through job creation and sales of high-quality products and services.***
  - ***Young Canadians represent an important portion of the workforce in the restaurant and foodservice industry, often gaining work experience and transferable skills.***
- ***The Government is focused on creating the conditions that will help people and businesses succeed in today's economy. With respect to youth, the government has***

introduced a series of measures to support youth employment, including Budgets 2016 and 2017 investments in the Youth Employment Strategy to create job opportunities for young Canadians.

- *Budget 2017 also provided $2.7 billion over six years in incremental funding to expand the Labour Market Transfer Agreements with provinces and territories. This incremental funding will help more Canadians access the training they need to succeed in the labour market.*
    - *This is on top of the nearly $3 billion annually that the Government already provides to provinces and territories for the design and delivery of skills training and employment supports aimed at helping workers prepare for, return to or maintain employment.*

If pressed on how the federal government could help mitigate the recent increases to provincial minimum wages, or on the possibility of introducing a credit on EI premiums to encourage companies to hire young Canadians, you could note:

- *Research suggests that direct youth programming, such as Canada Summer Jobs and other programs offered under the Youth Employment Strategy, is more effective than EI premium credits in creating jobs for young people.*
- *The Government is also studying the results of the Expert Panel on Youth Employment to determine barriers faced by vulnerable youth in finding and keeping jobs, and to examine innovative practices used across jurisdictions and by employers to improve job opportunities for vulnerable youth. Recommendations include:*
    - *Enhancing the Youth Employment Strategy and supporting Indigenous youth employment;*
    - *Streamlining and simplifying youth employment programming, in collaboration with the provinces and territories;*
    - *Engaging employers by convening a champions table and encouraging mentorship;*
    - *Modernizing support to youth employment by updating Canada's labour standards, broadening EI eligibility, and developing additional supports for young entrepreneurs; and*
    - *Developing better youth employment statistics.*

2. Credit card fees

Following several years of merchant concerns over credit card acceptance fees, the Government of Canada accepted separate and voluntary undertakings from Visa and MasterCard in November 2014. The undertakings reduce their average effective interchange fees to 1.50 per

cent for five years, which represented an aggregate reduction in merchant interchange fees of close to 10 per cent.

On September 14, 2016, the Government of Canada acknowledged the independent findings that both Visa and MasterCard met their respective commitments to reduce interchange fees. Additionally, the Government announced that in order to ensure that there is adequate competition and transparency for Canadian businesses and consumers when it comes to the fees they incur when using credit cards, the Government would conduct a further assessment of the fees set by card networks and review the effects of the voluntary fee reductions.

[redacted]

As part of their pre-budget consultations, Restaurants Canada recommended:

- A cap on interchange fees with rules preventing the introduction of other merchant fees to recoup lost interchange revenue.
- A level playing field for merchants.
- A stop to credit card companies profiting from taxes collected on behalf of governments.

If this issue is raised, you may wish to note:

- ***The Department of Finance is currently conducting an assessment of credit card fees to ensure there is an appropriate balance between the costs and benefits of credit card transactions for consumers and businesses.***
- ***As part of this assessment, Finance officials have met with several stakeholders, including Restaurants Canada.***
- ***Concerns expressed by Restaurants Canada are consistent with those of other stakeholders. These include the level of interchange rates and the range of rates faced by merchants.***
- ***The Government will keep your concerns in mind going forward.***

s.21(1)(c)

3. Alcohol Excise Duty Rates – Automatic Annual Inflationary Adjustment

Budget 2017 increased the excise duty rates on alcohol products by 2 per cent and automatically adjusted the rates by the Consumer Price Index on April 1 of every year, starting in 2018.

- The April 1, 2018 adjustment will be less than one cent per standard bottle of wine, about four cents per 24 bottles of beer, and about five cents per typical bottle of spirits.

Restaurants Canada proposes that the automatic annual inflationary adjustment mechanism be repealed. From their perspective, an annual increase based on the Consumer Price Index creates a dangerous precedent and adds significant costs to operators. They argue that because provincial alcohol mark-ups, fees and levies, along with provincial and federal sales taxes (including the Goods and Services Tax), are layered on to the excise duty, this creates a "cascading" effect. They further argue that the federal government should undertake an economic impact analysis of the automatic annual inflationary adjustment.

The Government of Canada recognizes the significant contribution that the alcohol beverages and foodservice industries make to the national economy through job creation and sales of high-quality products and services.

The Budget 2017 measure ensures that the effectiveness of the rates is maintained over time. Indexation is already a common feature of many provincial mark-up systems, as well as of many taxation systems in foreign jurisdictions.

Overall, the federal alcohol excise duty and Goods and Services Tax represent a small proportion of the total price of alcohol products.

If pressed on the "cascading" effect of alcohol excise duty rate increases, you may wish to note:

- ***Provinces and territories are responsible for their own policies. There is no reason that provincial and territorial mark-up and levy rates should automatically increase with federal rates.***

If pressed on economic impact analysis, you could note:

- ***The Department of Finance estimates that automatic annual inflationary adjustments will have a negligible impact on the demand for alcoholic beverages.***
- ***This assessment is supported by economic analysis showing that demand for alcohol products is relatively inelastic, or does not tend to change with small price movements.***

2018-2019 Federal Pre-Budget Submission

Presented to:

The Honourable Wayne Easter, P.C., M.P.
Chair of the House of Commons Standing Committee on Finance

Restaurants Canada

The voice of foodservice | La voix des services alimentaires

2018-2019 Federal Pre-Budget Submission

Restaurants Canada is pleased to present its submission to the House of Commons Standing Committee on Finance as part of its 2018 pre-budget consultations.

We are a national industry association representing 30,000 businesses in every segment of foodservice, including full- and quick-service restaurants, bars, caterers, and institutional foodservice providers.

The restaurant industry is one of the largest sectors of the Canadian economy with $80 billion in annual sales, 95,000 locations, and 1.2 million employees who serve 18 million customers every day. An additional 286,000 people are indirectly employed as suppliers to our industry. With restaurants in every community across the country, we are huge contributors to the economy, culture and fabric of our nation.

Question One:

"What federal measures would help Canadians to be more productive?"

The Canadian restaurant and foodservice industry provides more first-time jobs than any other industry. Twenty-two percent of Canadians started their career in a foodservice business. These jobs allow young Canadians to develop valuable jobs skills so they can progress within the industry, and serve as stepping stones to the broader labour force.

These important first job experiences are in jeopardy because of double-digit increases to mandated wage costs in the provinces of Alberta and Ontario, which could quickly spread to other Canadian jurisdictions. Employers cannot afford to pay first-time job-seekers the same wages as more experienced workers. When forced to increase wages at a pace that doesn't give them time to adjust, employers can no longer invest in these workers. The least experienced and least skilled, many of them youth, are the casualties of aggressive minimum wage policies.

Restaurants Canada is seeking mitigation from provincial governments to stem job losses from $15/hour minimum wage policies, but Restaurants Canada also recommends that the federal government:

- provide support in the form of fiscal incentives and tax credits to encourage the hiring and retention of young people and other marginalized Canadians;
- make job training grants more widely available to the restaurant industry. Asa not-for-profit association, we would welcome accompanying grants to help administer the additional coordination which would be required;
- fulfil the promise made during the electoral campaign to promote hiring of youth employees by granting a 12-month holiday on EI contributions. Unfortunately, this measure was not included in this administration's first two budgets. With youth unemployment 2.2 times higher than for workers over 25, it would encourage the hiring of young people;
- make EI beneficiaries eligible for labour mobility or transportation allowances to go to work where they are needed.

Question Two:

"What federal measures would help Canadian businesses to be more productive and competitive?"

We are pleased that the committee is focusing on policy measures to make Canadian businesses more productive and competitive.

After 26 years of continuous growth, the restaurant industry is faced with some daunting challenges that will limit its contribution to employment and economic development. Restaurants Canada is seeking support from the federal government to address some of the cost drivers negatively impacting the productivity and competitiveness of foodservice operators.

Labour and food represent the largest component of an operator's costs and there has been a sharp climb in labour costs in particular. Eighty-two per cent of respondents to Restaurants Canada's Q2 Restaurant Outlook Survey indicated that labour costs are the biggest challenge for foodservice operators, up dramatically from 69% in Q1. Respondents also indicated that food costs, labour shortages, utility costs, credit card merchant fees and liquor costs were hurting their businesses.

Despite the strong economy, the share of operators that are pessimistic about the next 12 months compared to the previous 12 months jumped to 28% in Q2 from 11% in Q1. Reducing operating costs over the next 12 months is a top priority, with seven in 10 indicating they will do so by reducing shifts and hours of work. Given the competitive nature of the business and the price-sensitivity of restaurant consumers, it is difficult for operators to pass on higher costs. However, 45% will be forced to raise their menu prices by more than 3% in the next 12 months.

With average before tax margins of only 4.3% across Canada, restaurant operators cannot continue to absorb costs. We have identified several issues that need federal government support. Support on these issues would reduce operator costs and taxes, which would positively impact their productivity and competitiveness:

1. **Credit card fees:** Credit card interchange fees are a major source of frustration for restaurant operators. The fees charged to merchants in Canada are amongst the highest in the world, and are still five times higher than in the European Union, Great Britain and Australia, despite modest fee reductions. The dollars merchants pay to credit card issuers is continuing to spike up because of the tremendous year-over-year increases in credit card usage. Canadians are incented to use their cards for all types of purchases to take advantage of generous reward points, but the rewards are financed by merchants through higher fees.

RESTAURANTS CANADA RECOMMENDS:

- A cap on interchange fees with rules preventing the introduction of other merchant fees to recoup lost interchange revenue.
- A level playing field for merchants.
- A stop to credit card companies profiting from taxes collected on behalf of governments.

2. **Escalator tax on alcohol:** This infamous tax was put in place in the 2017 budget. In our response to the budget, and in many public declarations, we accepted the one-year 2% increase to the alcohol excise tax. However, the annual increase based on CPI not only creates a dangerous precedent, but adds significant costs to operators and their customers that will accelerate quickly because of the cascading nature of alcohol taxes. Provincial mark-ups, fees and levies are all layered on to the excise tax increase along with provincial and federal sales taxes. Restaurants Canada was frustrated by the characterization of the tax as so insignificant, it didn't warrant any economic analysis. A similar alcohol excise tax escalator was banished in the 1980s because it was a job-killer.

   RESTAURANTS CANADA RECOMMENDS:

   - Repeal of the escalator excise tax on alcohol, and at a minimum, an economic impact analysis be undertaken.

3. **Interprovincial non-tariff barriers on alcohol**: Restaurants Canada welcomed the signing of the Canada Free Trade Agreement (CFTA) last spring. As Canada enters a general trade deal with Europe (CETA) and participates in talks to renegotiate NAFTA, it is more important than ever to limit trade barriers inside our own borders. We encourage all provinces to reduce trade barriers, but leadership must come from Ottawa.

The CFTA framework announcement was accompanied by the establishment of a federal/provincial working group to study interprovincial trade of alcohol. Currently, the provinces are challenging a New Brunswick court decision that is going to the Supreme Court on interprovincial trade barriers perpetuated by provincial liquor boards. We again appeal to the federal government for leadership to ensure the constitutional right of consumers and commercial enterprises to the free flow of goods and services, including alcohol, between provinces, is respected.

Reducing current infringements would increase access to unique products and more varieties from across the country, and lead to more competitively priced products for consumers.

RESTAURANTS CANADA RECOMMENDS:

- Leadership by the federal government to ensure the constitution is respected with regard to the free flow of alcohol between provinces.

4. **International trade:** Restaurants Canada also recognizes the powerful influences of global markets and the need for enhanced international trade.

Restaurants Canada believes that an openness to freer trade, and a strategy to boost our country's investment and trade ties to more countries, will stimulate higher and sustained growth, and in turn, job creation.

Restaurants Canada recommends that government guard against jeopardizing the 90% of Canadian farmers that are not supply-managed, as well as other Canadian value-added providers of goods and services that rely on trade, by maintaining its protectionist position on supply management during NAFTA renegotiations.

Canada's restaurant industry relies on Canada's dairy and poultry sectors, and has a vested interest in ensuring a reliable and competitive source now and in the future. At the same time, recent tightness in the chicken market and the challenge of getting products to specifications (right-sized birds) indicates the need for more efficient and open international markets.

RESTAURANTS CANADA RECOMMENDS:

- Freer international trade of agricultural products including supply-managed products.

5. **Small business tax reduction:** More than two-thirds of Canada's restaurants are locally owned and operated by independent entrepreneurs. These small- and medium-sized businesses operate at a very low pre-tax profit margin of 4.3%.

We were disappointed when the March 2016 budget cancelled a proposed reduction of the small business tax rate to 9%, particularly because it contradicted an electoral promise. A small business tax reduction would allow small restaurant enterprises to invest in their businesses and hire more Canadians.

RESTAURANTS CANADA RECOMMENDS:

- Reducing the small business tax from 11.5% to 9% in alignment with election platform.

6. **Culinary tourism promotion initiatives:** Restaurants Canada appreciated the announcement last spring that government is embarking on a strategy to make Canada a top destination for culinary tourism. We know that tourists are drawn to Canada's culinary landscape. In fact, restaurants are one of the top three reasons tourists choose Canada as their destination.

RESTAURANTS CANADA RECOMMENDS:

- Including funding to implement a culinary tourism strategy in the 2018 budget. We wish to collaborate on the strategy as private-sector partners.

7. **Marketing to kids:** Restaurants Canada understands the government's election commitment to introduce legislation to restrict marketing to kids. However, we are concerned that Health Canada's approach to this mandate is so sweeping, it will have negative consequences for the economy and Canadian treasury. The approach outlined to date includes a very narrow definition of what foods can be marketed, and a very broad range of activities that would be prohibited such as advertising, promotions, sponsorships, packaging, merchandizing, and labeling. In addition, the definition of child includes teenagers up to the age of 17, who will be able to work in restaurants but not be exposed to any communications from restaurants. Since teenagers typically watch the same programming as adults, restaurants will be prevented from marketing their businesses to any audience in Canada.

RESTAURANTS CANADA RECOMMENDS:

- Undertaking an economic analysis to measure the impact of any proposed marketing restrictions on the economy and Canadians. The analysis should consider the food, retail, and restaurant sectors, as well as Canada's advertising, broadcasting, and media industries. In addition, the impact on sporting, artistic and cultural events, charities, and community activities needs to be considered.

Department of Finance Canada | Ministère des Finances Canada

For Signature by / Information of À signer par / Pour l'information de Parliamentary Secretary	
Prepared by (name/initials/division) Préparé par (nom/initiales/division) Lucie Pilon	
In consultation with (name/initials/branch(es)/division(s)) En consultation avec (nom/initiales/direction(s)/division(s)) Jamila Bourgeois	
Approved by	Approuvé par
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Deputy Minister Sous-ministre	Paul Rochon
Remarks Remarques:	
SUBJECT / OBJET: **Parliamentary Secretary meeting Restaurants Canada**	
File no. No de dossier 2018FIN468137	Date JAN 3 1 2018

Associate Deputy Minister & G7 Deputy for Canada **Sous-ministre délégué et représentant du Canada au G7**	**(Sign on behalf of DM)** **(Signer au nom du SM)**	☐
Associate Deputy Minister **Sous-ministre déléguée**	**(Sign on behalf of DM)** **(Signer au nom du SM)**	☐
Assistant Deputy Minister **Sous-ministre adjoint(e)**	**(Sign on behalf of DM)** **(Signer au nom du SM)**	☑ C.L.

Department of Finance Canada | Ministère des Finances Canada

MEMORANDUM NOTE DE SERVICE

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Originator Auteur
Joshua Mechler

Our file Notre référence
[redacted]

Your file Votre référence
2018FIN468154

Date
JAN 3 1 2018

TO
À
Paul Rochon

Memo to Deputy Minister

DMO .... Orig. + 4
Assoc. DM & G7 Deputy 1
EFP .... e-copy
C&C .... e-copy
LAW .... e-copy

FROM
DE
Leah Anderson

SUBJECT
OBJET
Virtual Currencies

For information only.

Please find attached a copy of a background deck on virtual currencies.

[redacted]

If you would like further information, we would be glad to discuss any of the points in greater depth.

s.16(2)(c)

s.21(1)(a)

Eleanor Ryan, 613-369-4457
Julien Brazeau, 613-369-3698

Canada

Department of Finance Canada   Ministère des Finances Canada

VIRTUAL CURRENCIES

Financial Sector Policy
Finance Canada
January 2018

Canada

OUTLINE

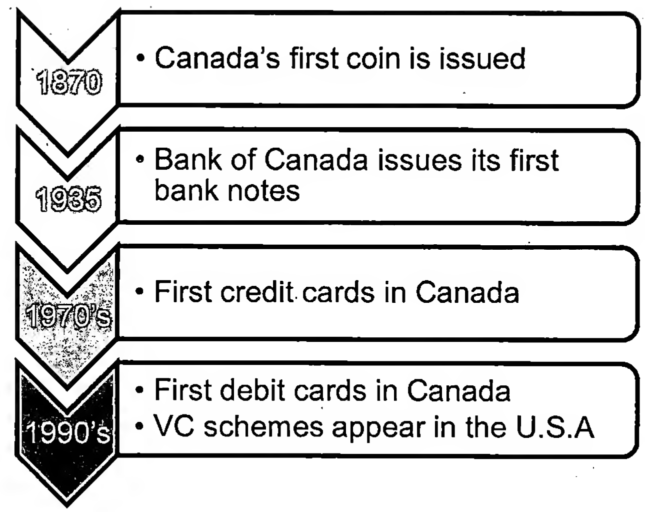
1. VIRTUAL CURRENCIES
2. CRYPTOCURRENCIES
3. [redacted]
4. POLICY RESPONSES IN OTHER JURISDICTIONS

s.21(1)(a)

1- VIRTUAL CURRENCIES

1- VIRTUAL CURRENCIES
A HISTORY OF VIRTUAL CURRENCIES

- In Canada, government authorized banknotes and coins have been the most common way to pay for goods and services. Until the 1970's, Canadians could only pay for goods and services through physical cash (Bank of Canada, 2005).
- Technological innovations such as credit cards and debit cards introduced the concept of digital currency (e-money). It was now possible to pay for goods and services without using physical currency.
- Digital currency is monetary value that is stored and transferred electronically. It is denominated in legal tender usually issued by a legal financial institution upon receipt of funds and is given a value in a national currency, such as the Canadian dollar (Bank of Canada, 2014).
- Virtual currency schemes appeared in the 1990s. These were not denominated in legal tender, but rather issued by private companies and usually accepted within a specific virtual community. They acted as a medium of exchange and as a unit of account within that particular virtual community.



Source: Bank of Canada, A history of the Canadian dollar, 2005.

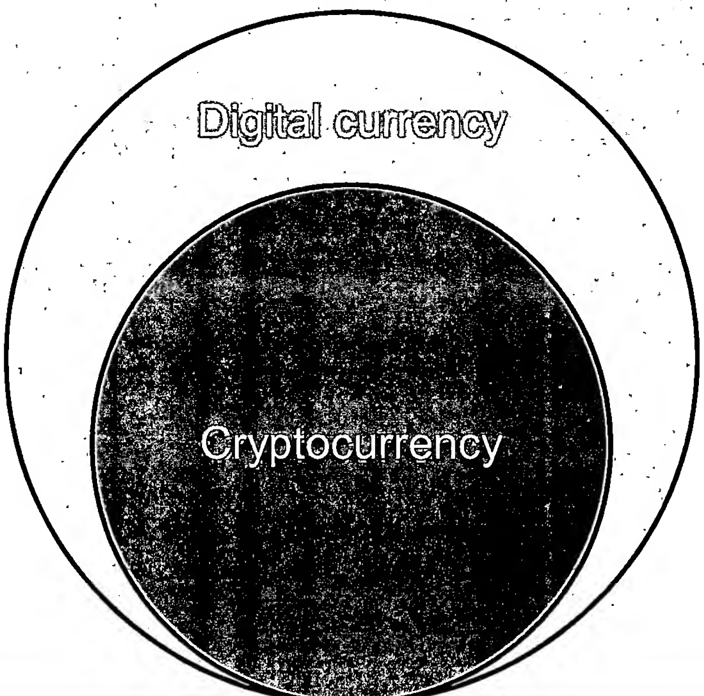
1- VIRTUAL CURRENCIES
WHAT ARE VIRTUAL CURRENCIES?

Virtual currencies (VCs) are digital representations of value, issued by private developers and denominated in their own unit of account. The concept of VCs covers a wider array of "currencies," ranging from simple IOUs of issuers (such as Internet or mobile coupons and airline miles), VCs backed by assets such as gold, and "cryptocurrencies" such as Bitcoin. VCs schemes have 2 characteristic elements:

1. The administrative authority:
- In a centralized VC scheme, a central authority administers the system.
- In a decentralized VC scheme, the administration of the system is shared among its participants.
- It is however possible to find hybrid models in some VC schemes.

2. The possibility of conversion in fiat currency:
- In a convertible VC scheme, VCs can be bought and converted into fiat currency and vice-versa.
- In a non-convertible VC scheme, VCs are isolated from the real economy and can not be converted into fiat currency.
- It is however possible to find hybrid models in some VC schemes.

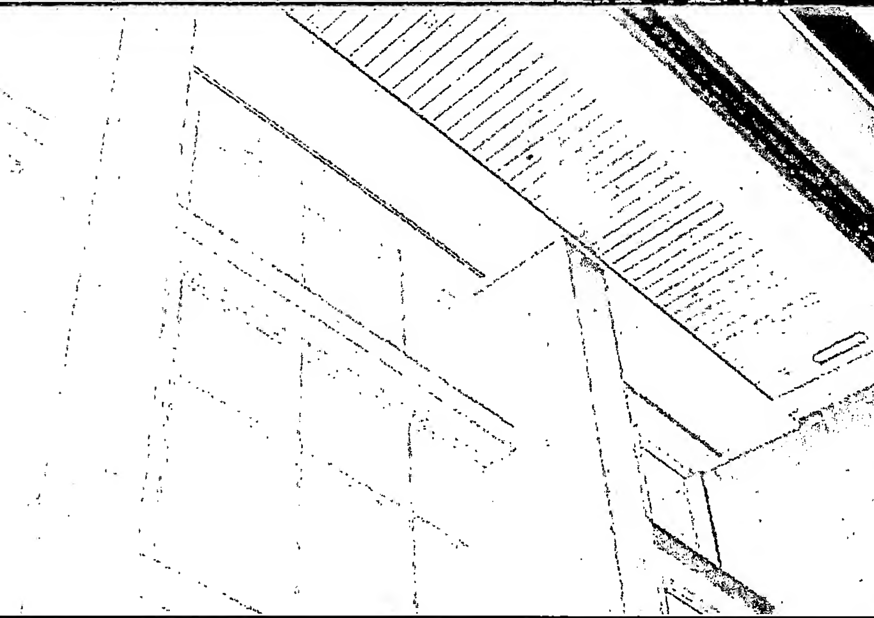
1- VIRTUAL CURRENCIES
CRYPTOCURRENCY : A FORM OF VIRTUAL CURRENCY



- While cryptocurrencies are a form of digital currency, they differ based on a few characteristics:
  - Cryptography:
    - A cryptocurrency utilizes cryptographic proof* instead of trust, allowing any two willing parties to transact directly with each other without the need for a trusted third party (Nakamoto, 2008).
  - Double-spending:
    - Cryptocurrencies utilize distributed ledger technology (DLT), which prevents an entity from spending the same coin/token twice (Nakamoto, 2008).
  - Convertibility:
    - All cryptocurrencies are convertible in fiat currency.

DLT is a protocol for building a replicated, decentralized and shared record ledger system.

*As it pertains to cryptocurrencies, cryptographic proof is the process of solving mathematical puzzles which protect transactions. When the puzzle is solved the solving party authenticates the transaction and receives compensation for their work.



2- CRYPTOCURRENCIES

Canada

2- CRYPTOCURRENCIES
WHAT ARE CRYPTOCURRENCIES?

- Cryptocurrencies are a form of distributed ledger technology, which utilize cryptology to validate and authenticate transactions.
- The key innovation of cryptocurrencies is the DLT, which allows a payment system to operate in an entirely decentralized way, without intermediaries such as banks.
- It is estimated that there are 1476 cryptocurrencies currently in existence.

[redacted]

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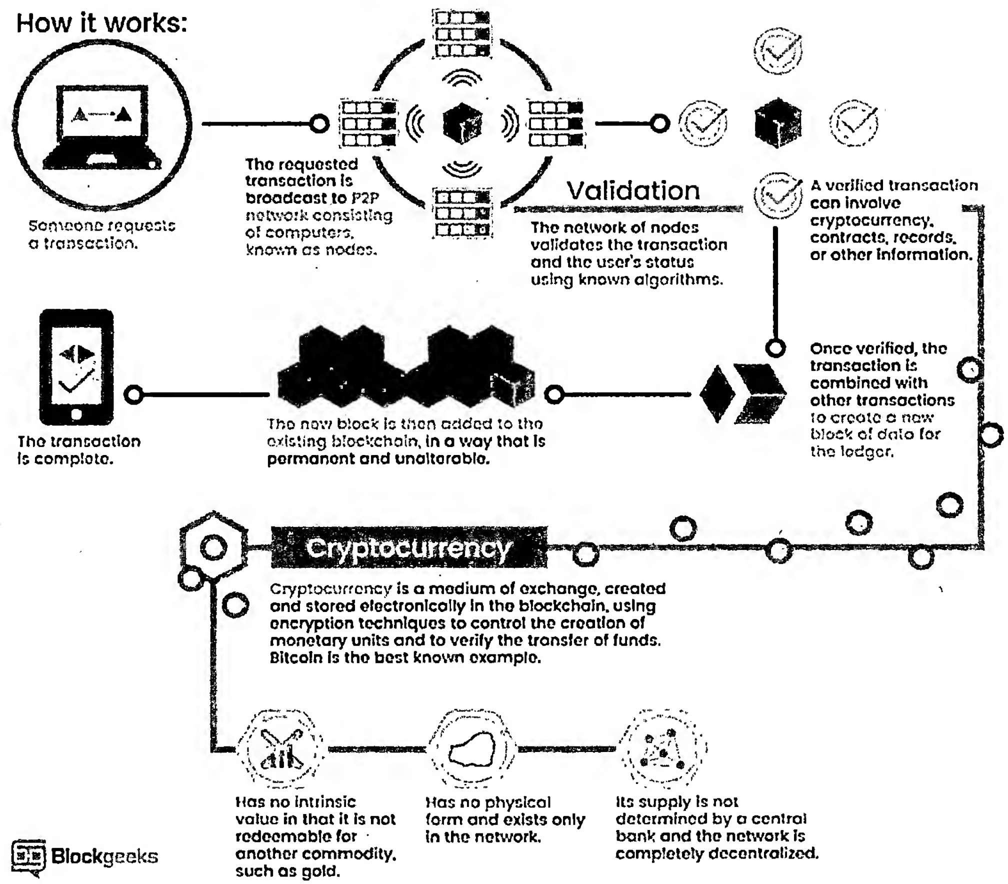
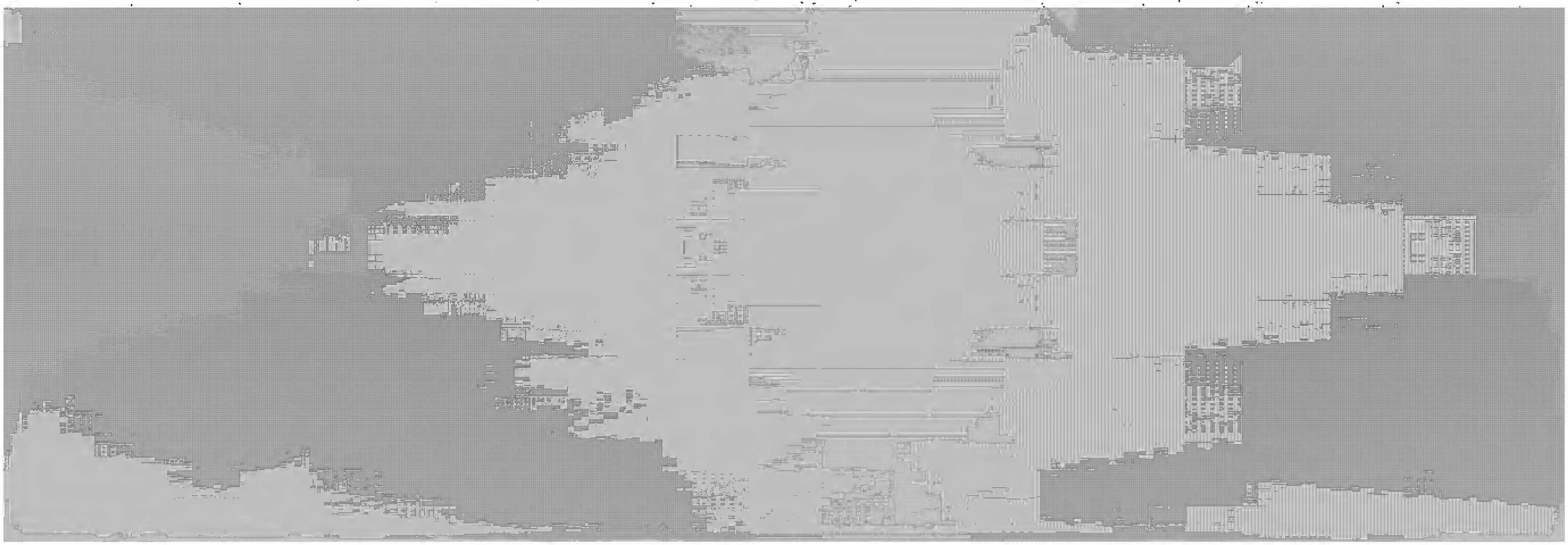
2- CRYPTOCURRENCIES
HOW DO CRYPTOCURRENCIES WORK?



2- CRYPTOCURRENCIES
WHAT DRIVES THE INTEREST IN CRYPTOCURRENCIES?



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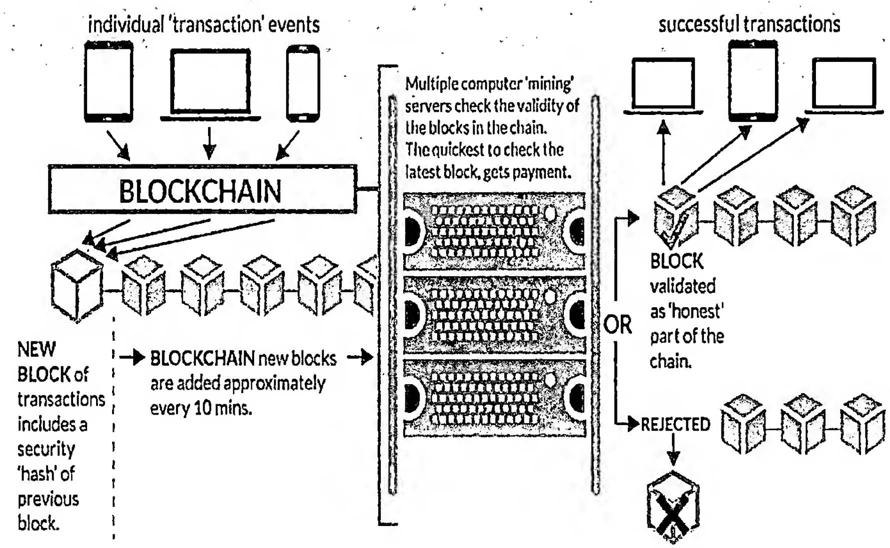
2- CRYPTOCURRENCIES DISTRIBUTED LEDGERS AND MINING

- Transactions are recorded in blockchains, which are distributed recordings of the past and present transactions of a specific coin/token.
- The transactions are verified, not through a central ledger or authenticator, but rather by 'miners'. Miners are individuals or groups, which use computing power in order to solve mathematical problems attached to a specific transaction. The first to solve the problem authenticates the transaction, and receives virtual currency as payment for their services to the network. Regardless of how cryptocurrencies are used, the role of the miner remains the same.
- The process of mining requires a great deal of energy. It is estimated that 0.5 percent of China's energy consumption is attributable to cryptocurrency mining (Coindesk, 2017). Due to the energy constraints in China, Chinese companies are reported to be considering moving operations to the energy rich Canadian market (Reuters, 2018).

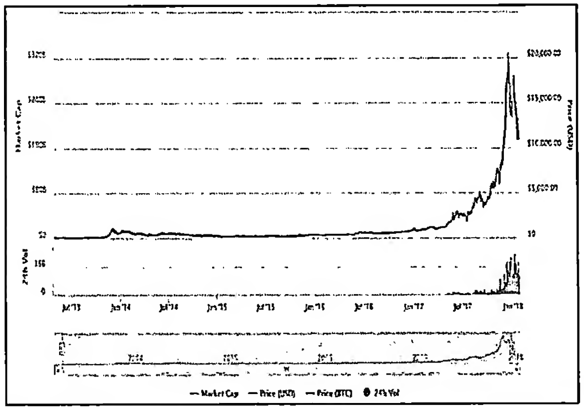


2- CRYPTOCURRENCIES
A HISTORY OF BITCOIN

bitcoin

- The Bitcoin network was created in 2009 by Satoshi Nakamoto, drawing from advances in cryptography and distributed ledger technology, such as blockchain.
- Bitcoin first appeared during the 2008-2011 financial crisis, during a period of low confidence in the mainstream financial system as a whole.
- Even though it started as a marginal network, Bitcoin has gained significant popularity over the past year, reaching an all-time peak of approximately 19,600 USD on December 17th, 2017. Despite the increasing number of competing cryptocurrencies, Bitcoin remains the largest and most popular cryptocurrency network.
- Owing to the anonymity afforded to users of virtual currencies, Bitcoin has been associated with the funding of illicit activities (e.g. hackers responsible for the worldwide May 2017 malware attack (Wannacry) required victims pay ransoms exclusively in Bitcoin currency). It is estimated that up to half of all transactions made with Bitcoin are associated with the buying and selling of illegal goods.

- Market Cap: $ 189,222,391,774 (January, 2018)
- Exchanges: > 100 globally, > 10 in Canada
- World's first Bitcoin "ATM" in Vancouver.



2- CRYPTOCURRENCIES
EXAMPLES OF CRYPTOCURRENCIES

The cryptocurrency market is large and growing with an overall capitalization of approximately 543 billion USD*. Bitcoin has a market share of approximately 35%*.

#	NAME	MARKET CAPITALIZATION*	PRICE*	CIRCULATING SUPPLY
1	Bitcoin	$ 189,222,391,774	$ 11,248.70	16,821,712 BTC
2	Ethereum	$ 98,668,754,599	$ 1,015.50	97,162,732 ETH
3	Ripple	$ 54,569,506,129	$ 1.41	38,739,142,811 XRP
4	Bitcoin Cash	$ 28,317,548,747	$ 1,672.87	16,927,525 BCH
5	Cardano	$ 15,038,919,484	$ 0.580047	25,927,070,538 ADA
6	Litecoin	$ 10,059,114,209	$ 183.27	54,885,958 LTC
7	Stellar	$ 9,018,949,459	$ 0.504757	17,867,903,683 XLM
8	NEM	$ 8,833,490,999	$ 0.981499	8,999,999,999 XEM
9	EOS	$ 8,426,272,095	$ 13.52	623,346,410 EOS
10	NEO	$ 8,241,090,000	$ 126.79	65,000,000 NEO

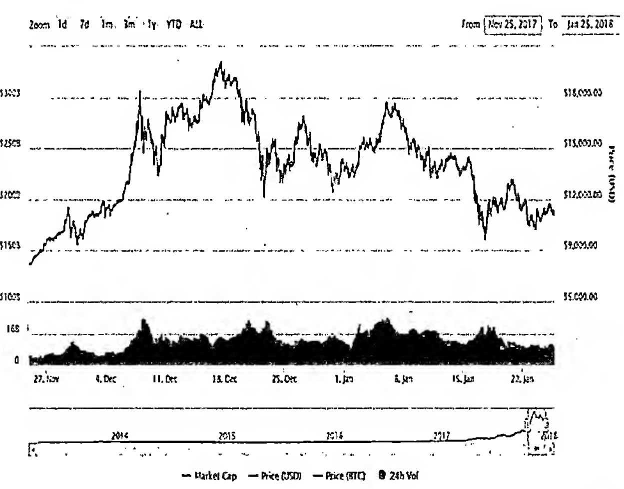
*As of January 23rd 2017,US dollars.
EOS is a token that uses the Ethereum network

2- CRYPTOCURRENCIES
WHAT DRIVES THE PRICE OF BITCOIN?

- Cryptocurrencies like Bitcoin have no intrinsic value. The intrinsic value is the actual value of a currency based on an underlying perception of its true value including all aspects of the business, in terms of both tangible and intangible factors.

- Likely contributors to increases in Bitcoin value are:
  - Limited supply and growing demand for bitcoins
  - Countries adopting Bitcoin friendly regulations
  - Growing number of merchants accepting bitcoins as a form of payment (e.g. Expedia, Microsoft, Subway restaurants, Shopify merchants)
  - Market speculation

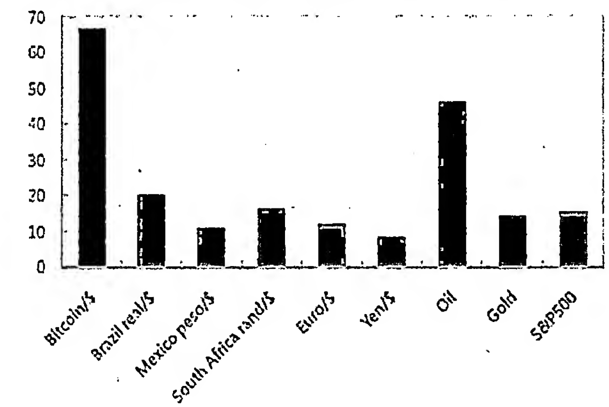
Bitcoin prices have been extremely volatile over the past several years



Source: IMF, 2016

...and more volatile than any other key currencies and assets.

Volatility of Bitcoin and Selected Currencies and Assets, 2015
(Standard deviation of daily price changes, annualized in percent)



2- CRYPTOCURRENCIES KEY STAKEHOLDERS

Cryptocurrencies have a large and diverse group of stakeholders including actors within the cryptocurrency market, the broader financial market and potential regulators.

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2- CRYPTOCURRENCIES THE CANADIAN ECOSYSTEM

- There are a growing number of cryptocurrency exchanges in Canada such as Canadian Bitcoins (Ottawa), Morrex (Sherbrooke), BitBuy (Toronto), and QuadrigaCX (Vancouver). These exchanges charge fees to convert between cryptocurrencies and to convert cryptocurrencies for fiat currencies. While exchanges are increasing in numbers, currency conversion fees remain high and the relative illiquid nature of cryptocurrencies as compared to Canadian dollars has resulted in large spreads between buy and sell prices.

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3- [redacted]

Canada

3- [redacted]

- **Money laundering:** Cryptocurrencies, including anonymity enhancing cryptocurrencies (AECs) are increasingly being used to launder proceeds of crime, pay for illicit activities, and evade sanctions. AECs are cryptocurrencies designed to better obfuscate transaction information and are increasingly preferred by bad actors, such as transnational criminal organizations. Silk Road, a Darknet market that served as a hub for anonymous transactions and the sale or brokering of forged documents, illegal services, drugs and weapons, was famously closed by the F.B.I in 2013. Bitcoins were the principal medium of payment on the Silk Road market.

- **Terrorist financing:** Exploiting existing vulnerabilities and enhanced privacy measures, terrorists organizations may use cryptocurrencies to evade authorities attention, protect the identity of their sponsors and the identities of beneficiaries of funds. The extent to which Bitcoin is actually being exploited for terrorist financing is unclear as current public information is extremely limited.

[redacted]

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3- [redacted]

[redacted]

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3 [redacted]

- **CSA approach has been to support this new capital-raising approach, while ensuring investors are protected and receive appropriate disclosure**
  - Issued guidance in August 2017 (consistent with SEC): noted that many ICOs to date were in effect securities offerings; encourages potential issuers to engage with their local securities regulator to discuss compliance with securities law.
  - SEC/CFTC recently issued a joint statement indicating that they would take action against market participants engaging in fraud through ICOs and other digital offerings.
  - No jurisdictions have implemented a regulatory framework specific to ICOs, but China and South Korea have banned them.

[redacted]

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3 [redacted]

[redacted]

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3-[redacted]

- The International Monetary Fund suggests that there are four major consumer risks relating to cryptocurrencies (IMF 2016):
  - Unproven and potentially unstable infrastructure
  - Unregulated intermediaries and service providers
  - Fraudulent activities
  - Irreversibility of transactions

- The Financial Consumer Agency of Canada (FCAC) recently published information and a warning regarding the risks of cryptocurrencies. The FCAC echoed many of the consumer risks identified by the IMF, including:
  - Fewer Protections – lack of complaint handling process such as those provided by debit and credit cards
  - Uninsured Deposits – digital currencies are not backed by federal or provincial deposit insurance plans
  - High Risk of Investment – highly volatile thus subject to large swings in value
  - Challenges in Exchanging your Digital Currency – supported by relatively few merchants and difficult to exchange for fiat currency
  - Exposure to Fraud
  - Irreversibility of Transactions

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3. [redacted]

- Most countries that have addressed this issue have determined that VCs will be treated for income tax purposes as non-currency (IMF, 2016).

- In a 2013 Factsheet, the Canada Revenue Agency explained that tax rules apply when a digital currency is used:
  - To pay for goods or services, as the rules for barter transactions apply (Interpretation Bulletin IT-490, Barter Transactions)
  - To be bought or sold like a commodity (Paragraphs 9 to 32 of Interpretation Bulletin IT-479R, Transactions in Securities)

- Additional issues include the tax treatment of newly-created VCs obtained through mining (in the case of cryptocurrencies)—as opposed to acquiring already existing VCs—and the value-added tax (VAT) and sales tax treatment of transactions involving VCs (IMF, 2016).

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4- POLICY RESPONSES IN OTHER JURISDICTIONS

Canada

4- POLICY RESPONSES – OTHER JURISDICTIONS SELECTED COUNTRIES

[redacted]

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4- POLICY RESPONSES – OTHER JURISDICTIONS SELECTED COUNTRIES

Jurisdictions	AML/CFT	Tax Treatment	Consumer Warning/Advisories	Licensing of VC Intermediaries	Financial Sector Warnings, and Bans	Bans on the Issuance/Use
Canada	Amending existing regulations	Transactions or speculations in cryptocurrencies are subject to general tax rules.	Advisory			
Argentina	Warning on the ML/TF risks		Warning		Warning on reporting entities	
Bolivia						Yes
China					Financial institutions are banned from cryptocurrencies transactions. Temporary ban on ICOs.	
France	Application of existing regulations	Transactions or speculations in cryptocurrencies are subject to general tax rules.	Warning			
Germany	Application of existing regulations	Transactions or speculations in cryptocurrencies are subject to general tax rules.				
Italy	Amending existing regulations	No income tax to pay if buying cryptocurrency for non-speculative activities.	Warning	Plan to introduce new regulations	Warning	

Source: IMF, 2016; DoF research, 2018

4- POLICY RESPONSES – OTHER JURISDICTIONS SELECTED COUNTRIES

Jurisdictions	AML/CFT	Tax Treatment	Consumer Warnings/Advisories	Licensing of VC Intermediaries	Financial Sector Warnings, and Bans	Bans on the Issuance/Use
Japan	Plan to introduce new regulations	Cryptocurrencies: assets and can be considered a payment method. However, not a legal currency.	Warning	New regulations		Legal payment option
Russia	Plan to introduce new regulations		Warning	Plan to introduce new regulations		Yes–draft law
Singapore	Plan to introduce new regulations	Cryptocurrencies are property for tax purposes.	Warning			
South Africa		Transactions or speculations in cryptocurrencies are subject to general tax rules.	Warning			
South Korea	Plan to introduce new regulations			Plan to introduce new regulations		
United Kingdom	Application of existing regulations	Cryptocurrencies: assets.				
United States of America	Application of existing regulations (Federal)	IRS: cryptocurrencies are property for tax purposes. CFTC: bitcoin as a commodity. SEC: case by case decision on ICOs and ETFs.	Warning	State licensing regimes (NY: BitLicense)		

Source: IMF, 2016; DoF research, 2018

Department of Finance Canada | Ministère des Finances Canada

MEMORANDUM NOTE DE SERVICE

Memo with Letter for Minister's Signature

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DMO.. 4
Assoc. DM & G7 Deputy...... 1
EFP.................................... e-copy
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Security classification Classification de sécurité
SECRET

Originator(s) Auteur(s)
Gorav Chaudhry
Sara Barnes

Our file Notre référence
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Your file Votre référence
2017FIN465271

Date
DEC 11 2017

TO / À: Minister of Finance

FROM / DE: Paul Rochon

s.21(1)(a)
s.21(1)(b)

SUBJECT / OBJET: **Approval of 2018 Terms and Conditions for CMHC Securitization Programs**

For action. Your signature is required by December 15, 2017 to enable the Canada Mortgage and Housing Corporation (CMHC) to continue to issue new guarantees under its securitization programs starting January 1, 2018. [redacted]

Summary

Pursuant to section 14 of the *National Housing Act*, the Minister of Finance is responsible for annually approving the terms and conditions of CMHC's securitization programs: *National Housing Act* Mortgage-Backed Securities (NHA MBS) and Canada Mortgage Bonds (CMB). These programs were developed to increase the availability and reduce the cost of residential mortgages in Canada by introducing a stable and low-cost funding source for lenders. The terms and conditions relate to the amount and price of the government guarantees associated with these programs, and the manner in which securities are to be issued.

The evolution of the terms and conditions over recent years reflects the desire to reduce the subsidization of mortgage funding and regulatory liquidity requirements through the programs, reduce the government's footprint in housing finance, and encourage further development of private mortgage funding markets. We believe that changes made in 2014, 2015 and 2016 have contributed to these objectives: a reduced share of mortgage activity is now funded through these programs, while funding/liquidity advantages relative to private market alternatives have narrowed, although residual advantages remain (particularly for CMBs).

Prevailing market conditions necessitate striking a balance between continuing to make progress on the government's long-term objectives above, and providing lenders and the housing market with time to adjust to multiple ongoing housing policy changes. Smaller lenders, in particular, are experiencing greater impacts from recent measures and have fewer means of adjustment.

- We recommend a small 20 basis-point (bps) increase in the 5-year term higher-tier NHA MBS guarantee fee (to 100 bps), to be implemented January 1, 2018. [redacted]

ADM: Leah Anderson (369-3620)
Director General: Elisha Ram (369-3968)

[redacted]

➤ We also support marginally increasing *approved* annual issuance limits for NHA MBS (from $130 billion to $135 billion) and the threshold level of the higher NHA MBS pricing tier (from $8.5 billion to $9 billion) to continue to phase in prior policy decisions. This change would not constitute a change to *effective* annual issuance limits. We also recommend that the CMB approved annual issuance limit remain unchanged at $40 billion. Under these parameters, the share of mortgage activity funded by NHA MBS and CMB would continue to decline.

Background

CMHC Securitization Programs

The first NHA MBS were issued in 1987, while CMB were created in 2001. These programs pool insured mortgages into securities that can be sold to investors to access funding or to satisfy regulatory liquidity requirements. Both programs offer a government guarantee on the timely payment of principal and interest to investors; as a result, they are attractive to investors and relatively low cost for lenders.

CMHC's securitization programs have increased the availability and reduced the cost of residential mortgages in Canada by decreasing funding costs for lenders. [redacted] Added competition should lead larger financial institutions to offer lower interest rates, thereby benefitting consumers and increasing overall efficiency.

Lenders also place a high value on access to government-backed securities for liquidity management purposes. NHA MBS and CMBs are designated as 'high-quality liquid assets' (HQLA), which makes them eligible for meeting increasingly stringent regulatory liquidity requirements. Given the ability of large banks to readily convert mortgages on balance sheet to NHA MBS, and their historically higher yield relative to other HQLA, NHA MBS have been used extensively by large banks to meet these liquidity requirements.

[redacted]

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s.21(1)(b)

s.21(1)(a)

s.21(1)(b)

[redacted] Additional background information on CMHC's securitization programs can be found in Annex A.

Recent Changes to the Terms and Conditions of CMHC Securitization Programs

Over the past several years, adjustments have been made to the terms and conditions to wind back the government's level of exposure to the housing market from the timely payment guarantee, and encourage the further development of private mortgage funding markets.

- Following a run-up in issuance post financial crisis, annual issuance limits were imposed in 2013 before being reduced slightly in 2014 to levels where they effectively remain today.
- In 2015, guarantee fees were raised for the first time since inception of the programs, and a two-tiered pricing approach was implemented for NHA MBS guarantee fees. The current structure features significantly higher pricing above a threshold calibrated such that it would only impact large lenders using the program to meet regulatory liquidity requirements.
- In 2016, you approved further fee increases to higher tier NHA MBS targeting large lenders only, and a restructuring of the program (additional detail on changes to date, including the 2016 restructuring are illustrated in Annex B).

In 2017, no effective changes were made to the programs, in order to provide industry time to adjust to the policy changes you announced in October 2016 for insured mortgages.

<u>2017 Market Developments</u>

Funding Cost and Liquidity Advantages

The Department compares the issuance costs associated with government-backed securities with private market alternatives for both funding and liquidity purposes to estimate the level of subsidization provided by CMHC's securitization programs.

[redacted]

Page 54

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21(1)(b)

of the Access to Information Act

de la Loi sur l’accès à l’information

[redacted]

Notable & Upcoming Housing Policy Measures

Although residual advantages for CMHC programs remain, potential changes to terms and conditions for 2018 need to be considered in the context of other housing finance developments. Recent and upcoming policy measures have materially altered the housing finance landscape, and may lead to permanent changes in how mortgage lenders, particularly small ones, fund their mortgages.

- <u>Changes to (Low-Ratio) Portfolio Insurance Eligibility Requirements</u>
  Minister of Finance, November 2016

  Small lenders with limited alternative funding options rely on CMHC securitization as a key funding source. Recent measures that impose much stricter criteria on new portfolio-insured loans – which must be securitized – have led lenders to pursue alternate higher-cost funding sources or adjust their business strategies, such as changes in product offerings, increases in mortgage pricing, or reducing the size of their loan book. As a result, large lenders who are less reliant on portfolio insurance and securitization to fund mortgages have seen increases in their market share over the last year at the expense of small lenders.

s.21(1)(a)

s.21(1)(b)

- <u>Changes to Capital Requirements for Mortgage Insurers</u>
  Office of the Superintendent of Financial Institutions (OSFI), January 2017

  At the beginning of this year, OSFI finalized its new capital framework for mortgage insurers, which saw capital requirements increase significantly for new low-ratio mortgage loans. As a result, new portfolio insurance premiums have become much higher and more risk-based, ultimately increasing lenders' cost of funding for low-ratio loans.

- <u>Changes to Mortgage Underwriting *Guideline B-20*</u>
  OSFI, January 2018

  At the beginning of next year, OSFI will implement revisions to its *Guideline B-20* to increase the quality of residential mortgage lending funded by federally regulated financial institutions (FRFIs). These changes impact FRFIs as well as mortgage finance companies, which fund their activities largely via sales to FRFIs or government-backed securitization programs. [redacted]

These are important and appropriate measures to support the stability of individual mortgage lenders, the financial system and the economy. The greater impact on small lenders, and the resulting changes in the competitive balance, are an expected consequence of shifting the policy focus towards stability. In considering changes to the terms and conditions of CMHC programs, it is relevant to keep in mind that there are material adjustments being undertaken in the mortgage and housing market, [redacted]

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[redacted]

NHA MBS and CMB Guarantee Fees

s.21(1)(b)

[redacted] we recommend increasing higher tier 5-year NHA MBS guarantee fees from 80 basis points to 100 basis points (a 7 basis-point annualized cost increase). Applying the fee increase exclusively to the higher tier effectively targets large lenders only, who are relatively less impacted by past and upcoming housing finance policy changes. [redacted]

We recommend targeting January 1, 2018 for the implementation of the higher tier NHA MBS guarantee fee increase. Large lenders will have sufficient time to adjust to the change in pricing as they do not reach the higher tier NHA MBS threshold until later in the year.

[redacted]

[redacted]

NHA MBS and CMB Issuance Limits

[redacted] we propose that the total amount of *effective* annual issuance for 2018 under the two CMHC securitization programs remain unchanged relative to 2017. We expect this would result in a decline in the size of CMHC securitization as a proportion of outstanding residential mortgage credit, as mortgage credit continues to grow in 2018.

Following the restructuring of the CMHC securitization programs in 2016 (outlined in Annex B), a stable level of CMB issuance will require an incrementally higher approved NHA MBS limit to accommodate higher demand for reinvestment assets (see Annex B for definition). As such, it is proposed that the total approved NHA MBS limit be increased to **$135 billion** from the current $130 billion – which would support effective issuance of $80 billion for the NHA MBS program itself, $40 billion for NHA MBS to be repackaged into CMBs, and $15 billion of reinvestment asset demand over the course of the entire year.

[redacted]

In addition, it is proposed that the threshold level above to which the higher NHA MBS pricing tier applies be increased to **$9.0 billion** for 2018, from the current $8.5 billion, to ensure issuance of CMBs and reinvestment assets are not affected by the more expensive higher tier NHA MBS fees. This increased limit also accounts for continued growth in mortgage credit, and ensures the higher tier of NHA MBS pricing affects only the institutions using these securities for liquidity purposes (i.e., the big 5 banks).

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Recommendation

[redacted]

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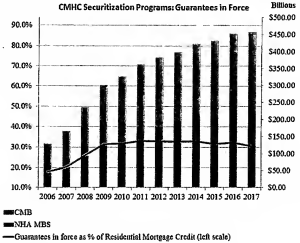
Annex A: Additional Background on CMHC Securitization Programs



Sources: CMHC Annual Reports, Statistics Canada

- NHA MBS are amortizing and pre-payable mortgage backed securities administered by CMHC.

- To provide investors with a bond-like investment (i.e. non-amortizing and carrying no prepayment risk) in 2001, CMHC established the CMB program.
    - Under this program, the Canada Housing Trust (owned by CMHC) purchases NHA MBS from approved sellers and uses swap transactions to convert the monthly principal and interest payments of the underlying NHA MBS into a stream of semi-annual coupon payments and a final bullet payment to CMB investors.
    - CMHC is required to pay the Receiver General a fee of 0.075 per cent of total CMB issuance for the government's ultimate backing of CMBs in the event that a financial institution operating as a swap counterparty defaults.

- Since their introduction, market demand has been considerably stronger for CMBs, due to their predictable cash flows.

- Both programs have grown considerably over time, from 20 to 30 per cent of total residential mortgage credit in Canada between 2007 and 2017.

- Following the financial crisis, NHA MBS have grown quickly as lenders sought the safety of government-backed liquid assets, and upon the introduction of Basel III liquidity requirements.

Annex B: Summary of Past Guarantee Limit and Fee Adjustments

Year	NHA MBS			CMB	
	Gurantee Limit	Guarantee Fee Upfront fee (annualized fee)		Gurantee Limit	Guarantee Fee
2013	$ 85 Billion	20 bps (7 bps)		$ 50 Billion	20 bps (4 bps)
2014	$ 80 Billion	20 bps (7 bps)		$ 40 Billion	20 bps (4 bps)
2015	$ 80 Billion	Lower Tier (≤ $6 billion) 30 bps (10 bps)	Higher Tier (≥ $6 billion) 60 bps (20 bps)	$ 40 Billion	40 bps (8 bps)
2016	$ 105 Billion	Lower Tier (≤ $7.5 billion) 30 bps (10 bps)	Higher Tier (≥ $7.5 billion) 80bps (27 bps)	$ 40 Billion	30 bps (6 bps) + NHA MBS Fee (~ 10 bps)
2017	$ 130 Billion	Lower Tier (≤ $8.5 billion) 30 bps (10 bps)	Higher Tier (≥ $8.5 billion) 80 bps (27 bps)	$ 40 Billion	30 bps (6 bps) + NHA MBS Fee (~ 10 bps)

* The guarantee fee is paid up front and covers the maturity of the security. Fees are annualized (i.e. costs presented on a per year basis) to facilitate comparison of securities with differing terms.

- Guarantee fees remained unchanged from inception of the NHA MBS and CMB programs until 2015 when pricing changes focused on the lower-cost CMB program and the largest users of NHA MBS. In 2016, fee changes exclusively targeted reducing large lenders' dependence on the program for regulatory liquidity purposes.

- NHA MBS issuance volumes have increased on an annual basis since 2016 to account for the restructuring of CMHC securitization programs, and the introduction of an additional class of NHA MBS termed "reinvestment assets":

  - Looking to give issuers greater flexibility regarding their use of NHA MBS, the distinction between NHA MBS issued for its own stake and NHA MBS to be repackaged into CMBs was eliminated in 2016. As such, new NHA MBS could be used, at times, to replace NHA MBS that have matured or amortized to ensure that a sufficient amount of securities underlie the associated CMB to cover coupon and principal payments through its life.[3] NHS MBS used for this purpose created an additional need for NHA MBS, which was reflected in the increased, approved issuance limits for 2016 (and 2017).

[3] As an amortizing instrument, the payments of the NHA MBS are comprised of both interest and principal, which are passed through to CMB investors. As the principal payments of the NHA MBS reduce the outstanding amount of NHA MBS backing the CMB, this causes a mismatch between the face value of the CMB and the underlying NHA MBS principal. Reinvestment assets are therefore used over the life of the CMB to ensure the outstanding principal on the NHA MBS remains sufficient to cover the interest payment and the bullet payment of principal at maturity.

Minister of Finance | Ministre des Finances

Ottawa, Canada K1A 0G5

SECRET

2017FIN465271

Mr. Evan Siddall
President and Chief Executive Officer
Canada Mortgage and Housing Corporation
700 Montreal Road
Ottawa, ON K1A OP7

Dear Mr. Siddall:

I am pleased to provide approval of the following terms and conditions for guarantees to be provided by Canada Mortgage and Housing Corporation (CMHC) during the year ending December 31, 2018, in respect of securities issued on the basis of housing loans (i.e., *National Housing Act* Mortgage-Backed Securities (NHA MBS) and Canada Mortgage Bonds (CMB)):

- New guarantees under the NHA MBS program shall not exceed $135 billion. This limit excludes NHA MBS issuance as reinvestment assets for CMB series issued before June 30, 2016;
- New issuance under the CMB program shall not exceed $40 billion;
- For the period beginning January 1, 2018 and ending December 31, 2018, guarantee fees under the NHA MBS and CMB programs will be adjusted from current levels according to the following;
    - The threshold for an issuer's annual NHA MBS guarantees up to which the lower NHA MBS guarantee fees apply will be increased from the current $8.5 billion to $9.0 billion;
    - An increase in guarantee fees from 80 basis points to 100 basis points for 5-year NHA MBS for an issuer's annual NHA MBS guarantees in excess of $9.0 billion (higher tier guarantees). The guarantee fees for other terms of higher tier guarantees are adjusted accordingly;
    - No change to NHA MBS guarantee fees for an issuer's annual NHA MBS guarantees up to $9.0 billion (lower tier guarantees);
    - No change to guarantee fees for CMB.

Canada

- Appendix A indicates the guarantee fees for all NHA MBS and CMB terms for the year ending December 31, 2018.

- The NHA MBS and CMB programs and the associated risk exposure will be managed in a manner consistent with the Minister of Finance's *Financial Risk Management Guidelines for Crown Corporations*;

- All securities guaranteed will be in Canadian Dollars. The maximum term for guarantees on NHA MBS issuance will be 25 years and the maximum term for guarantees on CMB issuance will be 10.5 years;

- Canada Housing Trust's purchase of fixed and floating rate NHA MBS, other than through short-term repurchase agreements, is restricted by terms to maturity not exceeding the maturity of the associated CMB series;

- Eligible assets for investment in the CMB program are limited to pools of insured mortgages in the form of NHA MBS, asset-backed obligations (no more than 10 per cent of the outstanding issuances of conduits 100 per cent backed by residential mortgages), Government of Canada securities and repurchase agreements with maximum terms of one month (with eligible counterparties using NHA MBS or Government of Canada securities with terms of no more than 10 years as collateral), all of which must mature no later than the associated CMB series; and,

- A fee will be payable by CMHC to the Receiver General of 0.075 per cent of total CMB issuance to compensate Her Majesty in right of Canada for exposure relating to guarantees provided under CMHC's securitization programs.

Further guarantee and issuance authority above the authorized amounts will be subject to my approval.

Yours sincerely,

The Honourable William Francis Morneau, P.C., M.P.

Enclosure

c.c. The Honourable Jean-Yves Duclos, P.C., M.P.
Minister of Families, Children and Social Development

Robert P. Kelly
Chairperson, CMHC Board of Directors

Appendix A: Guarantee Fee Schedule

Term of NHA MBS	Fee Payable NHA MBS Guarantees ≤ $9B	Fee Payable NHA MBS Guarantees > $9B
1 month to 6 months	0.05%	0.16%
7 months to 1 year 6 months	0.10%	0.33%
1 year 7 months to 2 years 6 months	0.15%	0.50%
2 years 7 months to 3 years 6 months	0.21%	0.70%
3 years 7 months to 4 years 6 months	0.26%	0.85%
4 years 7 months to 5 years 6 months	0.30%	1.00%
5 years 7 months to 6 years 6 months	0.35%	1.15%
6 years 7 months to 7 years 6 months	0.39%	1.30%
7 years 7 months to 8 years 6 months	0.44%	1.45%
8 years 7 months to 9 years 6 months	0.48%	1.60%
9 years 7 months to 10 years 6 months	0.53%	1.75%
10 years 7 months to 11 years 6 months	0.56%	1.85%
11 years 7 months to 12 years 6 months	0.59%	1.95%
12 years 7 months to 13 years 6 months	0.62%	2.05%
13 years 7 months to 14 years 6 months	0.65%	2.15%
Above 14 years 6 months	0.68%	2.25%

Term of CMB	Fee Payable
6 months to 2 years 6 months	0.15%
2 years 7 months to 3 years 6 months	0.21%
3 years 7 months to 4 years 6 months	0.26%
4 years 7 months to 5 years 6 month	0.30%
9 years 7 months to 10 years 6 months	0.60%

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sont retenues en vertu de l'article

21(1)(b)

of the Access to Information Act

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For Signature by / Information of À signer par / Pour l'information de Minister of Finance	
Prepared by (name/initials/division) Préparé par (nom/initiales/division) Sara Barnes/Gorav Chaudhry SB GC	
In consultation with (name/initials/branch(es)/division(s)) En consultation avec (nom/initiales/direction(s)/division(s))	
Approved by	Approuvé par
Director Directrice / Directeur	Cynthia Leach
Director General Directrice générale /Directeur général	Elisha Ram
Senior Advisor Conseiller Principal	Peter Routledge
Associate Assistant Deputy Minister Sous-ministre adjointe Déléguée	Annette Ryan
Assistant Deputy Minister Sous-ministre adjointe	Leah Anderson
Associate Deputy Minister & G7 Deputy for Canada Sous-ministre délégué et représentant du Canada au G7	Rob Stewart
Associate Deputy Minister Sous-ministre déléguée	
Deputy Minister Sous-ministre	Paul Rochon
Remarks Remarques:	
SUBJECT / OBJET: CMHC	
File no. No de dossier 2017FIN465271	Date DEC 07 2017

Associate Deputy Minister & G7 Deputy for Canada **Sous-ministre délégué et représentant du Canada au G7**	**(Sign on behalf of DM)** **(Signer au nom du SM)**	☑
Associate Deputy Minister **Sous-ministre déléguée**	**(Sign on behalf of DM)** **(Signer au nom du SM)**	☐
Assistant Deputy Minister **Sous-ministre adjoint(e)**	**(Sign on behalf of DM)** **(Signer au nom du SM)**	☐

Department of Finance Canada | Ministère des Finances Canada

MEMORANDUM NOTE DE SERVICE

Security classification / Classification de sécurité
SECRET

Originator/Telephone number / Auteur/Numéro de téléphone
Jean-Michel Desrosiers
Amélie Clément

Our file / Notre référence
[redacted]

Your file / Votre référence
2018FIN467704

Date
JAN 2 6 2018

SIGNED BY MINISTER
JAN 3 0 2018

TO / À: Minister of Finance

FROM / DE: Paul Rochon

SUBJECT / OBJET: **Restructuring of Interac Corporation**

For action. Your approval is **requested by January 30, 2018** in order for the applicants to complete the restructuring process prior to February 1, 2018 to avoid facing additional costs related to the proposed restructuring.

Issue

The Interac Group currently operates under a Consent Agreement from the Competition Tribunal, which recently authorized it to restructure under a new parent entity, Interac Corporation. The Consent Agreement would be terminated 915 days after the planned restructuring.

[redacted]

ADM: Leah Anderson (369-3878)
General Director: Eleanor Ryan (369-3904) / Lynn Hemmings (613-369-3865)

Canada

s.20(1)(b)
s.20(1)(c)
s.20(1)(d)
s.21(1)(a)
s.21(1)(b)

Background

Interac

In 1996, as a result of an investigation on whether Interac violated the *Competition Act* by unfairly restricting the participation of other organizations in its network, the Competition Tribunal issued an order that gave effect to a Consent Agreement between the Competition Bureau and Interac's owners to ensure competition in the payments sector. The Consent Agreement, which is enforceable by courts, prescribes how Interac is structured, how it is governed, who can access it, and how it sets and collects fees. It requires Interac's debit and ATM services (also called Shared Services) to operate on a not-for-profit basis.

As a result of this Consent Agreement, the organization was split into 3 main entities:

1. Interac Association, a not-for-profit entity with exclusive control over Shared Services and Interac Flash, a contactless debit solution. The Association is composed of 46 members, including the Applicants, and is governed by a board composed of individuals who are proposed and appointed by the members of Interac Association and indirect connectors to the network for a shared service.

2. Acxsys Corporation, a for-profit entity that provides services outside of the Consent Agreement, including Interac e-Transfer, Interac Online, mobile debit, cross border debit and international Automated Banking Machines. [redacted]

3. Interac Inc. [redacted] Interac obtained a variation to the Consent Agreement from the Competition Bureau and the Competition Tribunal in 2013. [redacted]

These amendments paved the way for the planned restructuring by authorizing the creation of a new parent company, "Interac Corporation", that would own all of the assets owned by Acxsys Corporation, Interac Inc. and Interac Association.

[redacted]

s.20(1)(b)

s.21(1)(a)

s.21(1)(b)

The revised Consent Agreement initially stipulated that the new corporation would be governed by an independent board, prior to and after the restructuring. However, the Consent Agreement was further amended in 2017 to allow the eight principal shareholders of Interac to also sit on the entities' board with the independent directors, [redacted]

The Consent Agreement, as amended in 2017, would terminate 915 days (approximately two and a half years) after Interac's restructuring, giving Interac the full flexibility thereafter to set its prices, access rules and governance model, including the power for shareholders to propose and vote for independent members to the board of directors.

JN *Approval*

The financial sector framework requires companies to seek Ministerial approval to acquire investments in financial technology entities. [redacted]

Your approval is sought by January 30, 2018, so that the Applicants can complete the restructuring of Interac Group prior to February 1, 2018. [redacted] The Act requires that the Applicants be notified prior to February 24, 2018 of your decision (or that you are extending the statutory period to consider the application).

[redacted]

Analysis

<u>Competition</u>

[redacted]

a) Price

[redacted]

b) Access

[redacted]

s.20(1)(b)

s.21(1)(a)

s.21(1)(b)

[redacted]

Business powers

[redacted]

The Department is also considering these activities under its fintech work in the 2019 Financial Sector Legislative Review, including how to protect customer information, to which privacy law currently applies. [redacted]

[redacted]

s.20(1)(b)

s.21(1)(a)

s.21(1)(b)

[redacted]

OSFI would convey that the approval does not rule out future policy changes in this area. The following standard statement would also accompany the signed approval: "Please note that the Minister's decision is only in respect of the legislation noted above and should not be construed as an endorsement in relation to any other federal legislation."

Recommendation

[redacted]

If you agree, please sign the order and the letters attached to the memorandum.

Attachments (7)

s.20(1)(b)

s.21(1)(a)

s.21(1)(b)

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20(1)(b), 20(1)(c), 21(1)(b)

of the Access to Information Act

de la Loi sur l’accès à l’information

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sont retenues en vertu des articles

20(1)(b), 21(1)(a), 21(1)(b)

of the Access to Information Act

de la Loi sur l’accès à l’information